

# CITY OF CALGARY **2013** ANNUAL INVESTMENT **REPORT**

CHIEF FINANCIAL OFFICER'S DEPARTMENT  
FINANCE & SUPPLY / TREASURY

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<i>I. INVESTMENT OVERVIEW</i>	<i>1</i>
<i>II. INVESTMENT OBJECTIVES</i>	<i>2</i>
<i>III. SOURCE OF INVESTMENTS</i>	<i>2</i>
<i>IV. INVESTMENT GOVERNANCE</i>	<i>3</i>
<i>V. SUMMARY OF CITY INVESTMENTS</i>	<i>4</i>
<i>VI. INVESTMENT PERFORMANCE</i>	<i>5</i>

# I. INVESTMENT OVERVIEW

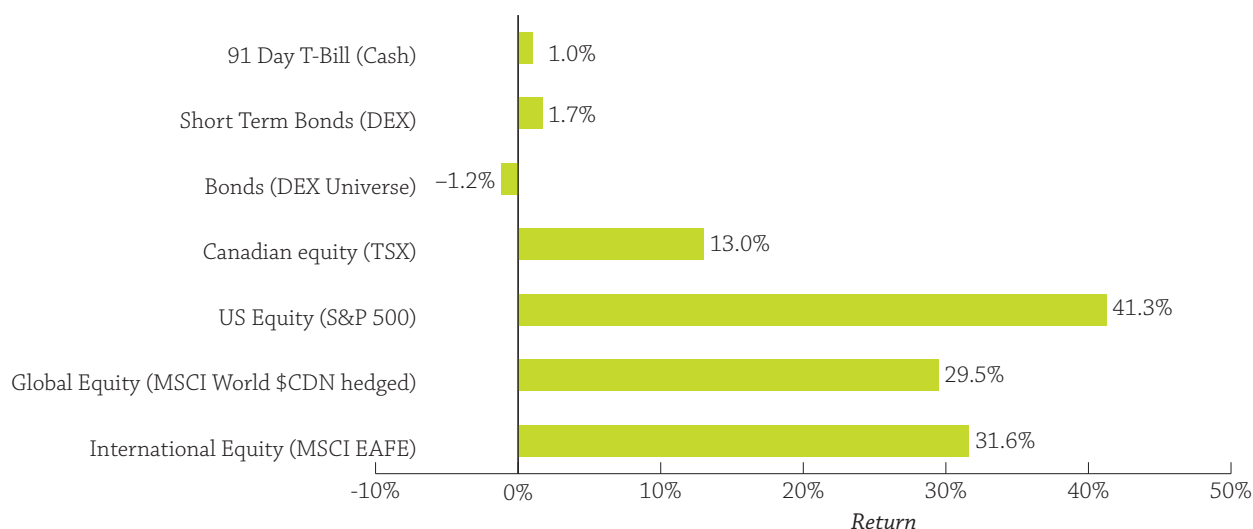
- Total investments under management were \$3.52 billion as at December 31, 2013 and generated \$63.4 million of realized investment income for The City during the year.
- Investments (including internally and externally managed assets), returned 2.31%, compared to the benchmark return of 1.97%.
- Equity markets performed significantly better in 2013, resulting in equity returns to The City almost double the previous year.
- Global and Canadian equity portfolios returned 30.02% and 15.14% respectively in 2013, offsetting lower bond returns during the year.
- Bond returns displayed a declining trend in 2013, due to rising bond interest yields during the year.
- Short term money market interest rates remained low throughout 2013; the Working Capital portfolio returned 1.32% compared to 1.27% in 2012.
- All asset classes outperformed their respective benchmarks during the year.
- Over a four year market cycle, performance of all City portfolios has been positive with all asset classes and investment managers outperforming their policy benchmarks.

## CAPITAL MARKETS REVIEW

In 2013, a moderate economic recovery took place in most of the developed world, spurring investor confidence and higher equity markets. Economic growth in the U.S. outpaced growth in Canada and most other developed countries. As a result, the U.S. equity market, as measured by the S&P 500 Index returned over 40% in Canadian dollar terms during the year, compared to the Canadian equity market which returned 13.0% in 2013.

A rapid rise in bond yields in the second quarter of 2013 slowed in the last half of 2013, resulting in modest negative returns for most of the Canadian bond market including mid and long term bonds. Looking forward, the Bank of Canada reduced its economic growth forecast for Canada in 2014, which might suggest a possible reduction rather than an increase in administered interest rates. The Canadian dollar experienced challenges in 2013, ending the year at \$1 Cdn. = \$0.94 U.S., down almost 7% against the \$U.S. and could experience further downward pressure in 2014.

**FIGURE 1 – 2013 CAPITAL MARKET RETURNS (\$CDN)**



## II. INVESTMENT OBJECTIVES

### PRESERVATION OF CAPITAL

- primary objective for total portfolio

### RISK MITIGATION

- diversification  
(asset class and security holdings)
- policy constraints and limits

### INVESTMENT RETURNS

- maximize returns relative to risk
- liquidity and investment time horizon considerations

In keeping with The City's investment objectives, investments generated a total return of 2.31% in 2013 which exceeded the portfolio's benchmark return of 1.97% and generated \$63.4 million of realized income for The City.

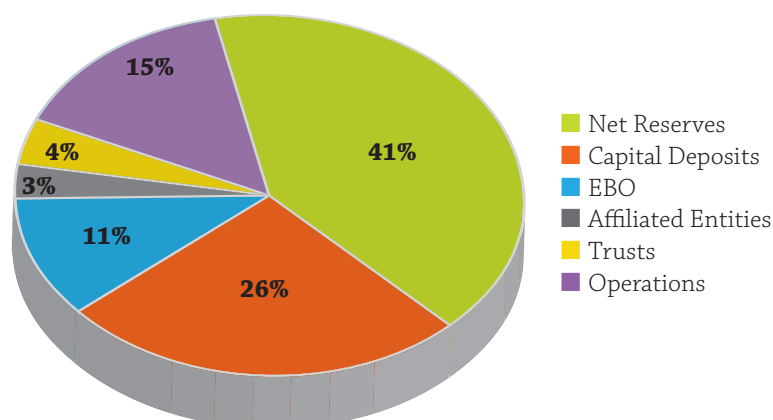
## III. SOURCE OF INVESTMENTS

### THE CITY OF CALGARY INVESTS FUNDS THAT STEM FROM SEVERAL SOURCES INCLUDING:

- General operations;
- Reserves (operating & capital);
- Funded employee benefit obligations (EBO)
- Capital deposits;
- Investments on behalf of affiliated entities; and
- Trust funds.

The funds are invested in a diversified portfolio of assets consisting of money market instruments, short term and long term government and corporate bonds, and equity investments, to meet The City's cash flow / liquidity requirements, as well as to match funds with longer-term time horizons.

FIGURE 2 – SOURCE OF INVESTMENTS







## IV. INVESTMENT GOVERNANCE

The City's Investment Governance Policy delineates the governance framework for the management of City investments. It sets out the accountability, reporting, and disclosure requirements for all investment activity. The Governance Policy establishes the roles and responsibilities of Council, the Investment Advisory Committee (IAC), Administration, and investment managers regarding management of portfolio investments. The IAC, which consists of seven members

(four senior executives from Administration at The City, and three external investment experts), oversees The City's investment program, to ensure that investments are optimally managed in accordance with Council approved policy. To meet investment objectives, the IAC applies best investment practices and met regularly in 2013 to review investment strategy and manager performance.

### ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG)

As a long term investor in Canadian and global capital markets, The City applies prudent investment management practices to achieve its designated investment objectives to preserve capital and maximize investment returns subject to an appropriate level of risk.

While investment managers do not create explicit screens to include or exclude certain investments or industries based on non-financial criteria, it is recognized that ESG factors can impact a company's financial performance and shareholder value. Companies that conduct responsible business practices and demonstrate high ESG standards are often a source of superior financial and investment performance. Therefore, as part of the investment process, portfolio managers look

for businesses that exhibit leadership in protecting the environment, demonstrating high social values, and acting in the best interest of investors.

Equity managers also utilize corporate engagement with company management and shareholder activism, including proxy voting, to encourage sound ESG practices. As a shareholder, The City has the right to vote on corporate policies and initiatives which we exercise via the proxy voting process. Also, our fixed income managers often consider a company's ESG practices as part of the credit analysis process when making investment decisions.

### RISK MANAGEMENT

The City manages investment risk through a sound governance framework and a comprehensive Investment Policy that follows industry best practice. The Investment Policy incorporates the requirements of the Municipal Government Act of Alberta and establishes appropriate guidelines and controls for the management of The City's investment portfolios including: investment objectives; eligible asset classes and security instruments; investment strategies; quality and quantity constraints; and appropriate diversification requirements.

Our investment managers apply rigorous investment analysis and practices and invest in quality investment grade securities that are diversified among security types, maturity dates, issuers, industry sectors, and geographically by countries and regions. This reduces the overall impact on the portfolio, if performance from any one category is adversely impacted.

As at December 31, 2013 all investments were in compliance with provincial regulations and The City of Calgary Investment Policy.

## V. SUMMARY OF CITY INVESTMENTS

As at December 31, 2013 the market value of The City's total investment portfolio was \$3,520 million, up from \$2,912 million in 2012.

The City's investment structure consists of both internally and externally managed portfolios. The internal portfolio is primarily managed to provide liquidity to meet City requirements and, as such, is invested in money market securities and short term bonds. In addition to the Working Capital portfolio, the Treasury group also manages a \$250 million short term ladder bond portfolio, structured to fund the capital cash flow requirements of the recreation centres' construction project.

Funds that are suitable for investment for longer periods are invested in the externally managed Short Term Bond, Long Term Bond, and Equity portfolios.

The City's external bond managers are currently Bissett Investment Management, Connor Clark & Lunn Investment Management, Phillips Hager & North Investment Management and PIMCO. The equity portfolio managers include Scheer Rowlett & Associates, Pyramis Global Advisors and TD Asset Management.

**FIGURE 3 – INVESTMENTS UNDER MANAGEMENT (\$millions)**

<b>Market Value as at December 31, 2013</b> <i>(includes cash and accrued interest)</i>	Working Capital	Short Term Bond	Long Term Bond	Equity	Total
<b>Internal Management</b>					
Working Capital	\$ 1,957				\$ 1,957
Short Term bonds	\$ 250				\$ 250
Trust Investments	\$ 87				\$ 87
<b>External management – Bonds</b>		\$ 513	\$ 476		\$ 989
<b>External management – Equities</b>				\$ 237	\$ 237
<b>Total</b>	\$ 2,294	\$ 513	\$ 476	\$ 237	\$ 3,520

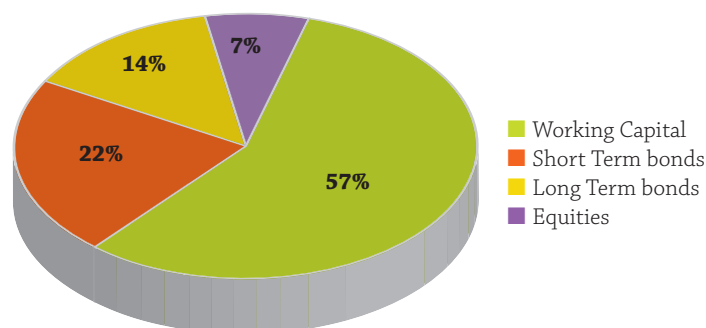
## INVESTMENT PORTFOLIO ASSET MIX

**FIGURE 4 – ASSET MIX**

Asset Class	Current Mix	Policy Mix Range	Long Term Target
Working Capital	57%	30-50%	35%
Short Term Bond	22%	0-30%	20%
Long Term Bond	14%	25-40%	35%
Equity	7%	5-10%	10%
<b>Total Portfolio</b>	<b>100%</b>		<b>100%</b>

Figure 5 below illustrates The City's current asset mix as at December 31, 2013.

**FIGURE 5 – CURRENT ASSET MIX**



## VI. INVESTMENT PERFORMANCE

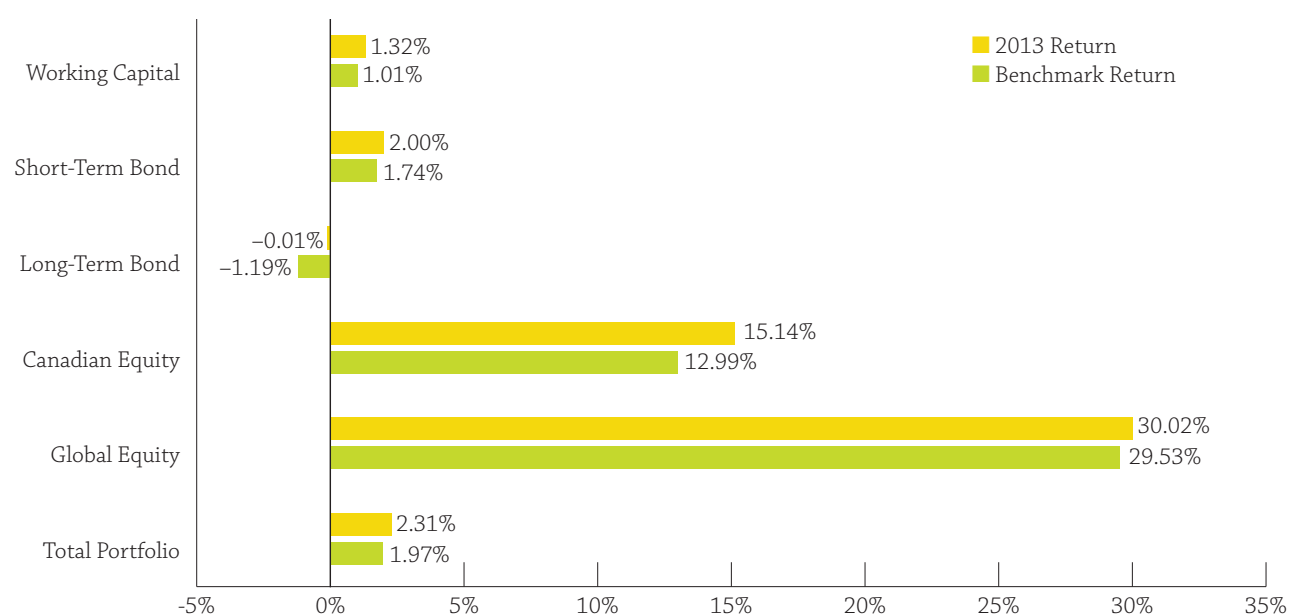
As illustrated in Figure 6 below, The City of Calgary's total portfolio (including internally and externally managed portfolios), returned 2.31%, compared to the benchmark return of 1.97% in 2013. Short term interest rates continued to remain low throughout 2013; however, the internally managed Working Capital portfolio returned a higher average yield of 1.32% compared to 1.27% in 2012.

Short term bonds returned 2.0% and outperformed longer bonds in 2013, due to rising mid and longer term bond yields. Both short

and long term portfolios exceeded their performance benchmarks over all time horizons up to 5 years as illustrated in Figure 7 below.

In contrast to bond returns, The City's global equities returned a stellar 30.02% in 2013, while Canadian equities provided smaller but still attractive returns of 15.14%. Equity portfolios also outperformed their respective benchmarks in 2013, and over four years as indicated in Figure 7.

**FIGURE 6 – 2013 ASSET CLASS RETURNS VS. BENCHMARK**



**FIGURE 7 – HISTORICAL ANNUALIZED PORTFOLIO RETURNS**

Annualized Returns as at December 31, 2013 (%)	1 Year	2 Years	3 Years	4 Years	5 Years
Working Capital Return	1.32	1.29	1.26	1.15	1.15
Working Capital Benchmark	1.01	1.01	1.01	0.89	0.84
Short Term Bond Return	2.00	2.40	2.94	3.25	4.23
Short Term Bond Benchmark	1.74	1.87	2.79	2.98	3.29
Long Term Bond Return	-0.01	2.16	4.40	5.17	6.01
Long Term Bond Benchmark	-1.19	1.18	3.93	4.63	4.78
Canadian Equity Return	15.14	12.12	4.08	7.14	-
Canadian Equity Benchmark	12.99	10.05	3.40	6.79	11.92
Global Equity Return	30.02	24.23	12.47	11.77	-
Global Equity Benchmark	29.53	22.53	12.32	11.54	14.57
Return on Total Portfolio	2.31	2.37	2.33	2.32	2.36
Benchmark	1.97	1.91	1.90	1.92	1.93

## PERFORMANCE MEASUREMENT BENCHMARKS

Investment performance is reported to the Chief Financial Officer and the Investment Advisory Committee on a quarterly basis and presented annually to the Audit Committee of The City. Investment benchmarks are used for comparison purposes to assess the actual performance of The City's various investment managers versus their respective performance benchmarks. Investment managers are expected to generate higher returns than the benchmark measured over rolling four-year periods.

## DESIGNATED ASSET CLASS BENCHMARKS

**WORKING CAPITAL:** DEX 91 DAY TREASURY BILL INDEX

**SHORT TERM BOND:** DEX SHORT TERM BOND INDEX

**LONG TERM BOND:** DEX UNIVERSE BOND INDEX

**CANADIAN EQUITY:** S&P/TSX COMPOSITE INDEX

**GLOBAL EQUITY:** MSCI WORLD INDEX (HEDGED TO \$CDN)

## WORKING CAPITAL PORTFOLIO

**Manager:** The City of Calgary, Treasury Division

**Mandate:** To effectively manage short term securities and liquidity for The City's operations and reserves within the constraints of daily cash flow requirements.

The portfolio is invested in a combination of corporate paper, and short term government and corporate bonds with the majority of investments maturing in less than two years.

### WORKING CAPITAL PORTFOLIO ANNUALIZED RATES OF RETURN

As at December 31, 2013 (%)	1 Year	2 Years	3 Years	4 Years	5 Years
<b>Working Capital Portfolio</b>	1.32	1.29	1.26	1.15	1.15
Benchmark (DEX 91 Day T-Bill Index)	1.01	1.01	1.01	0.89	0.84

Reflecting slightly higher short term interest rates in 2013, the internally managed Working Capital portfolio generated a return of 1.32% during the year compared to 1.27% in 2012.



## SHORT TERM BOND PORTFOLIO

**Managers:** Connor Clark & Lunn  
Phillips, Hager & North

**Mandate:** Investment in a diversified portfolio of short term fixed income securities with an average term to maturity of three to five years.

The combined portfolio balance between the two managers was \$513 million in 2013. The portfolio is primarily invested in a combination of Canadian government and corporate bonds.

### SHORT TERM BOND ANNUALIZED RATES OF RETURN

As at December 31, 2013 (%)	1 Year	2 Years	3 Years	4 Years	5 Years
<b>City of Calgary</b>	2.00	2.40	2.94	3.25	4.23
DEX Short Term Bond Index	1.74	1.87	2.79	2.98	3.29

The portfolio had a one year return of 2.00% for 2013. On a combined manager basis, the portfolio exceeded the return of the benchmark over all periods reviewed.

## LONG TERM BOND PORTFOLIO

**Managers:** Bissett Investment Management  
Connor Clark & Lunn  
Phillips, Hager & North  
PIMCO

**Mandate:** Investment in a diversified portfolio of fixed income securities with an average term to maturity of seven to ten years.

### LONG TERM BOND ANNUALIZED RATES OF RETURN

As at December 31, 2013 (%)	1 Year	2 Years	3 Years	4 Years	5 Years
<b>City of Calgary</b>	-0.01	2.16	4.40	5.17	6.01
DEX Universe Bond Index	-1.19	1.18	3.93	4.63	4.78

The City portfolio finished the year with a slight negative return while exceeding the benchmark by over 1.0%. Bond yields increased in Q2, 2013, resulting in declining bond prices and a decrease in total return. Moderately higher bond yields are expected over the coming year as global economic growth appears set to improve.

## CANADIAN EQUITY PORTFOLIO

**Managers:** Pyramis Global Advisors  
Scheer Rowlett & Associates  
TD Asset Management

**Mandate:** To seek long-term capital appreciation by investing in a diversified portfolio of large capitalized Canadian equities.

### CANADIAN EQUITY ANNUALIZED RATES OF RETURN

As at December 31, 2013 (%)	1 Year	2 Years	3 Years	4 Years
<b>City of Calgary</b>	15.14	12.12	4.08	7.14
S&P/TSX Composite Index	12.99	10.05	3.40	6.79

The Canadian equity market posted strong gains in 2013, finishing the year with a return of almost 13.0%. All sectors of the market ended the year with positive gains, except the material sector, which was negatively affected by declining base and precious metals prices.

## GLOBAL EQUITY PORTFOLIO

**Managers:** Pyramis Global Advisors  
TD Asset Management

**Mandate:** Investment in a diversified portfolio of large capitalized global (international) equities located in developed markets.

### GLOBAL EQUITY ANNUALIZED RATES OF RETURN (\$CDN)

As at December 31, 2013 (%)	1 Year	2 Years	3 Years	4 Years
<b>City of Calgary</b>	30.02	24.23	12.47	11.77
MSCI World Index (hedged to \$CDN)	29.53	22.53	12.32	11.54

In 2013, the global equity market as measured by the MSCI World Index (hedged to \$CDN) for developed countries posted a stellar return of almost 30%. The City's total return was 30.02% in 2013 and managers outperformed the benchmark over the past four years.





